No. 304

In the Supreme Court of the United States

OCTOBER TERM, 1938

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHESTER N. WEAVER COMPANY, A CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion and dissenting opinion in the United States Board of Tax Appeals (R. 20–38) are reported in 35 B. T. A. 514. The opinion and dissenting opinion in the Circuit Court of Appeals (R. 68–76) are reported in 97 F. (2d) 31.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 2, 1938 (R. 67). The petition for certiorari was filed on August 26, 1938, and was

granted on October 10, 1938. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a liquidating dividend is to be treated as a sale or exchange within the meaning of Section 23 (r) (1) of the Revenue Act of 1932, which allows the deduction of losses from sales and exchanges of stocks and bonds which are not capital assets only to the extent of the gains from such sales or exchanges.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra*, pp. 23–29.

STATEMENT

Respondent, a California corporation, on August 9, 1932, purchased 1,000 shares of the preferred stock of Jeff R. Townsend Company for $100 a share (R. 22).

Early in 1933 the Townsend Company became financially involved and unable to continue business. Its stockholders took the necessary steps to effect its liquidation and dissolution. On or about September 17, 1933, respondent purchased all the assets of the Townsend Company for $26,280.50. This sum was distributed in liquidation pro rata to the preferred stockholders of the Townsend Company. On September 18, 1933 (less than two years from the date of purchase of the stock), re-

spondent received $13,140.25 of the distribution in liquidation, and surrendered its stock certificates for cancellation (R. 22–23).

In its income-tax return for 1933 respondent deducted as a loss the difference between the amount paid for the preferred stock and the amount received in liquidation (R. 23). The Commissioner disallowed the deduction, determining that the loss was sustained from an exchange of stock held less than two years, within the meaning of Section 23 (r) (1); and that respondent had no such gain against which the loss could be applied (R. 13, 23). The Board, five members dissenting, entered an order sustaining the deficiencies (R. 38–39). The Circuit Court of Appeals, Circuit Judge Stephens dissenting, reversed the decision of the Board (R. 68–76).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the liquidating dividend was not a sale or exchange within the purview of section 23 (r) (1) of the Revenue Act of 1932 (c. 209, 47 Stat. 169).

2. In holding that the loss resulting from the liquidation is deductible under the provisions of sections 22 (d), 115 (c), and 112 of the Revenue Act of 1932.

SUMMARY OF ARGUMENT

I. Section 23 (r) (1) of the Revenue Act of 1932, limiting the deduction of losses on "sales or ex-

changes of stocks and bonds" to the extent of gains from such exchanges, in the absence of such gains in the present case bars the deduction of the loss upon the corporate liquidation. Under section 115 (c), providing that the amount distributed to the taxpayer in the liquidation shall be treated as in exchange for the taxpayer's stock, the liquidation is in effect a sale or exchange of the stock within section 23 (r) (1). The legislative history of section 23 (r) (1) does not support the taxpayer's contention that a corporate liquidation is not a sale or exchange of stock within section 23 (r) (1).

II. The loss is not deductible in virtue of sections 22 (d), 115 (c), and 112 without reference to section 23 (r) (1). These sections merely determine the amount of the loss which is to be "recognized" and do not determine the additional question whether the loss is deductible. Under section 23 (r) (1) the loss is not deductible.

ARGUMENT

THE DEDUCTION OF THE TAXPAYER'S LOSS UPON THE CORPORATE LIQUIDATION IN 1933 IS PROHIBITED BY SECTION 23 (r) (1) OF THE REVENUE ACT OF 1932

On August 9, 1932, the taxpayer, a corporation, purchased 1,000 shares of the preferred stock of another corporation for $100,000. On September 18, 1933, less than two years later, the taxpayer surrendered the certificates of preferred stock for cancellation and received $13,140.25 in the complete liquidation of the other corporation. The tax-

payer deducted the resulting loss of $86,859.75 from gross income in its 1933 income tax return (R. 6–7).

The Commissioner of Internal Revenue (R. 9) and the Board of Tax Appeals, five members dissenting (R. 20–38), determined that deduction of such a loss is limited by section 23 (r) (1) of the Revenue Act of 1932 to the extent of offsetting gains, and since there were no such gains disallowed the loss and determined a deficiency of $4,323.48. The court below held, Circuit Judge Stephens dissenting (R. 68–76), that the loss is deductible. The petition for certiorari granted October 10, 1938, asserts a conflict with *White* v. *United States*, 21 F. Supp. 361 (C. Cls.), certiorari granted October 10, 1938, Nos. 96 and 97, present Term, to be argued immediately before this case.

The petitioner contends that deduction of the loss (I) is barred by section 23 (r) (1) and (II) is not allowed, as the court below held, "by virtue of sections 22 (d), 115 (c), and 112" (R. 69).

I

SECTION 23 (r) (1) BARS THE DEDUCTION

The taxpayer is a corporation. Section 13 of the 1932 Act levies a tax for each taxable year upon the net income of every corporation. Section 21 provides:

> "Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

Consequently, the petitioner contends, the taxpayer may deduct from gross income only those deductions allowed by Section 23. Moreover, "only as there is clear provision therefor can any particular deduction be allowed." *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440.

The respondent in its brief in the court below relied upon section 23 (f) as the statutory authority for the deductions and, although section 23 (f) by its terms is limited by section 23 (r), contended that section 23 (r) (1) does not apply to corporate liquidations. The petitioner contends that section 23 (r) (1) does apply to corporate liquidations and prohibits the deduction.

Section 23 provides:

> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (f) *Losses by corporations.*—Subject to the limitations provided in subsection (r) of this section, in the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.
>
> * * * * *
>
> (r) *Limitation on stock losses.*—
>
> (1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101), shall be allowed only to the extent of the gains from such sales or exchanges (including gains

which may be derived by a taxpayer from the retirement of his own obligations).

* * * * * *

(t) *Definition of stocks and bonds.*—As used in subsections (r) and (s), the term "stocks and bonds" means (1) shares of stock in any corporation, * * *.

Section 101 (c) (8) provides:

"Capital assets" means property held by the taxpayer for more than two years * * *.

The petitioner contends (1) that the claimed deduction is prohibited by the words of section 23 (r) (1); (2) that the language of section 23 (r) (1) so clearly denies the claimed deduction that recourse to its legislative history is not proper or necessary; (3) that the legislative history of the section supports the petitioner's construction; and (4) that the petitioner's construction does not produce a harsh result.

1. *The terms of section 23 (r) (1) forbid the deduction*

Section 23 (f), the statutory authority for the deduction relied upon by the respondent in its brief in the court below, by its own terms is expressly subject to the limitations of section 23 (r). Consequently, the deduction cannot be allowed if it is prohibited by section 23 (r) (1).

Concededly, the stock was held by the taxpayer for less than two years and, therefore, was not

capital assets. It is not denied that the taxpayer in 1933 did not have gains from sales or exchanges of stock or bonds which were not capital assets to the extent of which the claimed deductions would have been allowed by section 23 (r) (1). This section applies, therefore, if the exchange of the taxpayer's stock for the liquidating dividend in cash is within the phrase "sales or exchanges of stocks" in section 23 (r) (1).

The petitioner contends that exchanges of stock in liquidation are in effect, and in virtue of section 115 (c), "sales or exchanges of stocks" within section 23 (r) (1). The petitioner's construction is supported by (a) section 115 (c); (b) the judicial decisions, applying section 115 (c), which determine that exchanges of stock in corporate liquidations are sales or exchanges of stock; (c) the clear understanding of Congress that section 115 (c) treats corporate liquidations as a "sale of stock"; and (d) the treatment of liquidations as sales of stock, applying section 115 (c) under sections of the revenue acts other than section 23 (r) (1).

a. Section 115 (c) provides in part:

> (c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under

> section 111, but shall be recognized only to the extent provided in section 112. * * *

In these plain terms section 115 (c) provides that amounts distributed shall be treated as payment in exchange for stock. The petitioner contends that where, as here, the amount distributed is cash there is a sale of the stock within the phrase "sales or exchanges" in section 23 (r) (1).

b. The decisions, applying section 115 (c), hold that corporate liquidations shall be treated as what they in effect are—sales of stock to the corporations in liquidation, taxable in like manner as if the stockholders had sold their stock to third persons. *Hellmich* v. *Hellman*, 276 U. S. 233, 237; *Langstaff* v. *Lucas*, 9 F. (2d) 691, 694 (W. D. Ky.), affirmed 13 F. (2d) 1022 (C. C. A. 6th), certiorari denied, 273 U. S. 721.

In the *Hellmich* case this Court held that amounts distributed in liquidation to stockholders out of earnings after February 28, 1913, were not "dividends" under section 201 (a) of the 1918 Act exempt from the normal tax, but were payments in exchange for stock under section 201 (c), similar to section 115 (c) of the 1932 Act, subject to the normal tax. The opinion of the Court by Mr. Justice Sanford states at page 237:

> The gains realized by the stockholders from the distribution of the assets in liquidation were subject to the normal tax in like manner as if they had sold their stock to third persons.

In the *Langstaff* case the District Court, reaching the same result which this Court later reached in the *Hellmich* case, said at page 694:

> This section [201 (c) of the 1918 Act] strips distributions made to stockholders in liquidation of a corporation of all disguises and declares that they shall be considered for what they in effect are—purchases of all their outstanding stock by the liquidating corporations, and not dividends as generally understood, and as defined in section 201, subsection (a), and as used in section 216.

The Circuit Court of Appeals affirmed upon the reasoning of the District Judge and stated (13 F. (2d) 1022) that the amount distributed in liquidation "became the proceeds of the sale of Langstaff's stock in the corporation, instead of a corporate dividend."

It is submitted, therefore, that for tax purposes liquidations are in effect "sales or exchanges" of stock within the meaning of that phrase throughout the revenue acts and in section 23 (r) (1). Nothing in the language of section 23 (r) (1) indicates that the phrase has a different or more restricted meaning than that required by section 115 (c).

c. The provision of section 115 (c) requiring amounts distributed in liquidation to be treated as payments in exchange for the stock first appeared in section 201 (c) of the Revenue Act of 1918, and

has been repeated in section 201 (c) of the Acts of 1924 and 1926 and section 115 (c) of the 1928 Act and subsequent Acts [1] Congress has always considered that section 115 (c) "treats a liquidating dividend as a sale of stock, * * *."[2]

This treatment of corporate liquidations as a sale of stock supports the petitioner's view that the corporate liquidation in this case was a sale of stock within the meaning of section 23 (r) (1).

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[1] The Revenue Acts of 1921, 1917, 1916, and 1913, make no specific provision for liquidating dividends. *Lynch* v. *Turrish*, 247 U. S. 221; *Lynch* v. *Hornby*, 247 U. S. 339, 343–346; Magill, *The Income Tax Liability of Dividends in Liquidation*, 23 Mich. Law Rev. 565, 569 (1925).

[2] The Senate Committee on Finance (Rep. No. 398, 68th Cong., 1st Sess.) used this language in speaking of the section of the bill which became section 201 (c) of the Revenue Act of 1924, the predecessor of section 115 (c) of the 1928 and subsequent Acts, and stated at page 11:

"* * * The bill treats a liquidating dividend as a sale of the stock, with the result that the gain to the taxpayer is treated not as a dividend subject only to the surtax but as a gain from the sale of property which may be treated as a capital gain. The treatment of liquidating dividends under the bill is substantially the same as provided for in the revenue act of 1918. A liquidating dividend is, in effect, a sale by the stockholder of his stock to the corporation; he surrenders his interest in the corporation and receives money in place thereof. Treating such a transaction as a sale and within the capital gain provisions is consistent with the entire theory of the act and, furthermore, is the only method of treating such distributions which can be easily administered."

A similar statement is made by the Ways and Means Committee of the House (Rep. No. 179, 68th Cong., 1st Sess., p. 11) with respect to section 201 (c) of the 1924 Act.

Indeed, liquidations were so clearly treated as sales of stock under the 1932 and prior Acts, taxable as capital transactions within the phrase "sale or exchange of capital assets" in section 101 (c) of the 1932 and prior Acts, that when Congress wished to change this rule, in view of the use of liquidations as a device to avoid surtaxes on corporate distributions, it was required to add expressly to section 115 (c) of the 1934 Act the limitation that "Despite section 117 (a) [the capital gains and losses section in that Act comparable to section 101 of the former Acts] 100 per centum of the gain so recognized shall be taken into account in computing net income." The Report of the Senate Committee on Finance (Rep. No. 558, p. 37, 73d Cong., 2d Sess., Appendix, *infra*, p. 29) discussing the change, recognized that under the 1932 Act a liquidation was treated in the same manner as a sale of stock in which gain was taxable at the capital gain rate and loss was correspondingly limited, if the shareholder had held the stock for more than two years.

d. Finally, corporate liquidations have been treated as sales or exchanges of stock under sections of the revenue acts other than section 23 (r) (1). Redemption of preferred stock, held more than two years and considered as a partial liquidation under section 115 (f) of the 1932 Act and as an exchange within section 115 (c), has been held to be within the phrase "sale or exchange of capital assets" within section 101 (c) (1) and, therefore,

taxable as a capital gain rather than as an ordinary gain. *Mary S. Childs* v. *Commissioner*, 35 B. T. A. 1125, 1127. In *Martin General Agency* v. *Commissioner*, 36 B. T. A. 1328, the Board held in an unreported memorandum decision (1937 Prentice-Hall Federal Tax Service Vol. 1, Par. 271, p. 258) that a corporate liquidation was within the phrase "sale or exchange of capital assets" in section 23 (j) of the 1934 Act.[3] See also *White* v. *United States*, 21 F. Supp. 361 (C. Cls.), certiorari granted October 10, 1938, Nos. 96 and 97, Present Term, which treats a corporate liquidation as a sale or exchange of capital assets within section 101 (c) of the 1928 Act.

Nothing in the terms of the statute indicates that a liquidation which is treated as a sale of stock under section 115 (c) and is the sale of stock for income tax purposes generally is not within the same phrase "sales or exchanges of stocks" in section 23 (r) (1).

The petitioner submits that the treatment of a corporate liquidation as the sale or exchange of stock both under section 115 (c) and under the decisions applying section 115 (c) requires the conclusion that the liquidation in this case is a sale of stock within the term "sales or exchanges of stocks" in section 23 (r) (1).

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[3] This case is pending, argued but undecided, in the Ninth Circuit Court of Appeals, awaiting decision in the instant case.

2. *The long accepted meaning of the words used in section 23 (r) (1) makes unavailable reference to the legislative history of that section*

The words "sales or exchanges of stocks" since 1924 had been understood clearly to include exchanges of stock in corporate liquidations when they were used in section 23 (r) (1) of the 1932 Act. Where there can be no doubt of the meaning of the words used, reference to the legislative history of the tax statute is not available. *Helvering* v. *City Bank Co.*, 296 U. S. 85, 89. This rule applies with particular force in the present situation where the phrase to be construed, "sales or exchanges of stocks", has long been considered to include exchanges of stock in corporate liquidations.

3. *The legislative history of section 23 (r) (1) does not support the taxpayer's contention.*

Even if the words of section 23 (r) (1) were not too plain to permit recourse to legislative history, as the petitioner contends, that history does not support the taxpayer's contention that Congress did not intend to include losses in corporate liquidations within "sales or exchanges of stocks". The dissenting opinion in the Board seems to have been based solely on this ground (R. 32–38). The opinion of the court below does not seem to place any reliance, expressly at least, upon this ground (R. 70).

The petitioner contends (a) that the express statutory exceptions to section 23 (r) forbid further exceptions by implication and (b) that the classification of non-capital assets, assets held for two years or less, adopted in section 23 (r), requires the conclusion that all sales or exchanges of stocks held for two years or less, including such sales or exchanges in corporate liquidations, are included.

a. Section 23 (r) expressly exempts transactions by dealers in securities in the ordinary course of their business and transactions by banks and trust companies, or persons carrying on a banking business, in the ordinary course of such banking business. Further relief from the operation of section 23 (r) (1) was given by adding section 23 (r) (2) which permitted a limited carry-over of losses to the succeeding taxable year. A provision, section 23 (s) of the bill in the House, limiting losses on sales or exchanges of stocks and bonds which were capital assets in the same manner as such exchanges of non-capital assets, was eliminated in the Senate. The petitioner submits that the existence of these express limitations on the operation of section 23 (r) (1) indicates that Congress did not intend additional limitations by implication, such as the taxpayer seeks. *Moore Ice Cream Co.* v. *Rose*, 289 U. S. 373, 377.

b. The dissenting members of the Board apparently relied upon reference in the committee reports to sales or exchanges "in the stock and bond markets" and to "preventing speculative losses."

At the most these references indicate that one purpose of Congress was to limit losses on speculative transactions. The method adopted, however, to accomplish this purpose was not by limiting losses on sales in markets or speculative losses as such but by limiting losses on sales or exchanges of stocks and bonds held for two years or less. The reference in the House Report to "losses sustained in the stock and bond markets" is followed immediately by a statement that section 23 (r) provides a limitation upon "losses from the sale or exchange of stocks and bonds held for less than two years."[4] A limitation on losses from sales or exchanges of stocks and bonds held for less than two years was the method chosen to accomplish the purpose of Congress.

The Report of the Senate Finance Committee, discussing the elimination of Section 23 (s) of the bill which limited losses even on securities held for

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[4] Report of the House Ways and Means Committee (Report No. 708, 72nd Cong., 1st Sess., pp. 12–13) states: "Many taxpayers have been completely or partially eliminating from tax their income from salaries, dividends, rents, etc., by deducting therefrom losses sustained in the stock and bond markets, with serious effect upon the revenue. Your committee is of the opinion that some limitation ought to be placed on the allowance of such losses.

"Subsection (r) provides that losses from the sale or exchange of stocks and bonds held for less than two years shall be deductible only to the extent of the gains from sales or exchanges of such securities. The same rule is applied by subsection (s) to losses from stocks and bonds held for more than two years."

more than two years, stated that such securities have been in the hands of investors and under the existing law were subject to sufficient limitation but that transactions in stocks and bonds held for two years or less "which obviously comprise the bulk of speculative transactions" were in a somewhat different situation and the losses should be limited.[5]

Thus Congress chose the practical classification based on the length of time the securities were held to distinguish "probable investment income

[5] The Report of the Senate Finance Committee (Report No. 665, 72nd Cong., 1st Sess.) states at p. 10:
"Securities held for more than two years have been in the hands of investors."

The Report continues at p. 17:

"Your committee, while in general agreement with the purpose of the House bill, believes that the method adopted to carry out this purpose is somewhat too drastic in that it penalizes pure investment losses as well as mere speculative losses.

"As now drafted the limitation that losses on stocks and bonds can only be taken to the extent of gains from similar transactions is confined to the sale of such securities which have been held for two years or less. Gains or losses arising from the sale of stocks or bonds held for over two years are in all cases treated precisely as under present law whether such losses are incurred by a corporation or an individual. * * * Further limitation appears unnecessary in view of the above and because of the fact that these transactions are usually non-speculative in character.

"The method recommended by your Committee in dealing with transactions in stocks and bonds held for two years or less, which obviously comprise the bulk of speculative transactions, may be stated as follows: The excess of losses over gains in these transactions is not allowed as a deduction against other income, * * *.

and losses and probable speculative income and losses * * *." *Davis* v. *United States*, 87 F. (2d) 323, 325 (C. C. A. 2nd). No attempt was made to exclude all transactions not in fact speculative although involving assets held less than two years. Certainly it was not intended that losses on such transactions should be subject to no limitation when even losses on assets held for more than two years are limited.

The reference to stock and bond markets in the committee reports was merely a recognition of one of the methods in which such losses can be realized, and does not purport or intend to exclude other methods. Indeed, sales on stock and bond markets, available for the stock and bonds of large corporations, is normally not available for stock of relatively small corporations, such as the corporation liquidated in this case, which must be sold privately or liquidated to realize the loss.

Certainly, the reference to stock and bond markets in the committee report does not exclude private sales of stock from section 23 (r) (1). Equally, it is no reason for excluding exchanges of stock for liquidating dividends.

4. *The petitioner's construction does not involve a harsh or absurd result*

The court below stated that the petitioner's construction of section 23 (r) (1) should be avoided on the ground that it limits the deduction of the loss if there is any liquidating dividend, although if there were no liquidating dividend, and the stock

were worthless, the entire loss could be deducted (R. 70). The petitioner submits (a) that the different treatment of stocks exchanged for liquidating dividends and worthless stocks does not establish that the former are incorrectly treated, and (b) that the general rule cannot be modified to meet a supposed harsh result in a stated hypothetical case.

a. The fact that the deduction of the loss from worthless securities is not limited does not indicate that the statute should not be construed as limiting the loss in this entirely different situation where the securities are not worthless and are in fact exchanged for a liquidating dividend. Indeed, the treatment of worthless securities as a loss from the sale or exchange of capital assets under section 23 (k) (2) of the Revenue Act of 1938 indicates that the asserted unequal treatment of liquidating dividends and worthless securities was due to the failure to treat worthless securities as a sale or exchange rather than the failure to treat exchange of stocks in corporate liquidations like worthless securities under former acts.

b. The suggestion that in a stated hypothetical case a harsh or illogical result will follow from the conclusion that a distribution is an exchange within the intendment of section 23 (r) is answered by the decision of this Court in *Helvering* v. *Twin Bell Syndicate*, 293 U. S. 312, 321. Cf. *Lang* v. *Commissioner*, 289 U. S. 109, 113; *Echols* v. *Commissioner*, 61 F. (2d) 191, 192–194 (C. C. A. 8th). Equally illogical results will ensue from the application of

the section, as the respondent construes it. The holder of stock purchased for $100,000 (held less than two years) who sells it for ten cents can deduct his loss of $99,999.90 only to the extent of similar gains, while, under the decision below, if the ten cents were received as a liquidating dividend, he could deduct the loss. Again, one who has a gain of $100,000 upon the sale of a capital asset may be taxed at 12½%, while under the decision below, if the gain results from a liquidation and, therefore, is not gain from the "sale or exchange of capital assets," it must be returned at the normal and surtax rates—rates up to a total of 63%.

II

THE LOSS IS NOT DEDUCTIBLE UNDER SECTIONS 22 (d), 115 (c), AND 112

The Circuit Court of Appeals held (R. 69)—

> We think that petitioner is entitled to the deduction by virtue of sections 22 (d), 115 (c), and 112. The amount received by petitioner was a liquidating dividend. Under section 22 (d), that dividend is taxable as provided in section 115 (c). Under the latter section the gain or loss is to be computed under section 111 but the amount arrived at by the computation shall be recognized to the extent provided in section 112. Under section 112 the entire amount of the loss must be recognized.

As pointed out in the dissenting opinion of Judge Stephens (R. 73–75), this holding not only violates the fundamental rule that the Congressional intent

is to be gathered from the structure and plan of the statute as a whole, but also renders the loss provisions of section 23, and other sections of the statute wholly nugatory.

1. Sections 11, 12, and 13 of the Revenue Act of 1932 levy a tax for each taxable year upon the net income of every individual and every corporation. Section 21 provides that: "Net income means the gross income computed under section 22, less the deductions allowed by section 23." It is evident, therefore, that to support the right to take a deduction it is necessary to show it is authorized by section 23. *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440.

The sections relied upon by the majority of the court below do not permit deduction of a loss. Section 22 (d) (Appendix, *infra*, p. 23) deals solely with the ascertainment of gross income. Section 115 (c) (Appendix, *infra*, p. 28) provides that amounts distributed in liquidation shall be treated as in "full payment in exchange for the stock" and that the gain or loss "resulting from such exchange" shall be determined under section 111, but "shall be recognized only to the extent provided in section 112." Hence, the purport of the decision below is to allow the loss under section 22 (d) as a *minus* item of gross income, or under section 112 because it is there "recognized." The view that Congress intended to allow a deduction under a section directed to the computation of gross income to the exclusion of the section devoted to deductions seems clearly untenable. This view violates the

rule that the meaning of the statute is to be determined from its provisions as a whole (*Hellmich v. Hellman*, 276 U. S. 233, 237) and the rule that, if possible, the statute is to be construed to render all of its provisions operative.

2. Nor is "recognition" of a loss under Section 112 in any sense a determination that the loss is deductible. That section deals with exchanges in connection with a "reorganization," as defined in the statute, and other non-taxable exchanges. Its purpose is merely to determine whether a gain or loss is to be recognized for tax purposes at the time of a particular transaction or whether recognition is to be postponed in whole or in part. If a loss is recognized the question remains whether it is deductible under section 23. Otherwise, even a loss on a sale to a third person would not be limited. In the present case section 23 (r) (1) bars the deduction.

CONCLUSION

The decision below is clearly erroneous and should be reversed.

Respectfully submitted.

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NOVEMBER 1938.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 13. TAX ON CORPORATIONS.

(a) *Rate of tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation, a tax of 13¾ per centum of the amount of the net income in excess of the credit against net income provided in section 26.

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SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit or gains or profits and income derived from any source whatever. * * *

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(d) *Distribution by corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

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(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

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(e) *Losses by individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business;

* * * * * *

(f) *Losses by corporations.*—Subject to the limitations provided in subsection (r) of this section, in the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * * *

(r) *Limitation on stock losses.*—(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

* * * * * *

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a

capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) *Tax in case of capital net loss.*—In case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition—

(A) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.

(B) In determining the period for which the taxpayer has held property however ac-

quired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(C) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain is recognized to the distributee under the provisions of section 112 (g) of this Act or the Revenue Act of 1928, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

(D) In determining the period for which the taxpayer has held stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 118 of this Act or the Revenue Act of 1928, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, there shall be included the period for which he held the stock or securities the loss from the sale or other disposition of which was not deductible.

(d) *Collection and payment of tax.*—The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

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SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the

gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b), and the loss shall be the excess of such basis over the amount realized.

* * * * *

(c) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section. * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. * * *

Revenue Act of 1924, c. 234, 43 Stat. 253:

DISTRIBUTIONS BY CORPORATIONS

SEC. 201. * * *

(c) Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock,

and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 202, but shall be recognized only to the extent provided in section 203. * * *

Report of the Committee of Finance of the Senate (Rep. No. 558, 73d Cong., 2d Sess., p. 37):

> Under existing law, a distribution in liquidation of a corporation is treated in the same manner as a sale of stock. This rule has serious objections, as it permits wealthy stockholders to escape surtax upon corporate earnings or profits distributed in the form of liquidating dividends. For instance, a corporation may have a surplus of $1,000,000. If the surplus is distributed as an ordinary dividend, it is subject to the surtax rates in the hands of the shareholders. If it is distributed as a liquidating dividend, it is subject only to the flat capital gain rate of 12½ percent in case the shareholder has held his stock for more than 2 years.

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